Q2 2018 | Putnam Multi-Asset Absolute Return Fund Q&A

Fund advances amid challenging market backdrop

Robert J. Schoen
CIO, GAA
Industry since 1990

James A. Fetch
Co-Head, GAA
Industry since 1994

Jason R. Vaillancourt, CFA
Co-Head, GAA
Industry since 1993

Increased global trade and political tensions created a challenging market environment in the second quarter.

Broad weakness in non-directional strategies largely offset positive results from directional strategies this period.

We made several positioning adjustments that were based on technical signals and fundamental value, and added new non-directional strategies to the portfolio.

Note: On April 30, 2018, the fund's name was changed from Putnam Absolute Return 700 Fund.

What was the investment environment like during the second quarter of 2018?

The period was marked by a continued flattening of the U.S. Treasury yield curve, along with increased global trade tensions.

Short-term yields rose more than longer-term yields during the quarter, reflecting market activity related to Federal Reserve policy. The Fed increased its target for short-term rates to 1.75% to 2.00% at its June policy meeting, the second hike this year and the seventh in the past three years.

As the year has progressed, the Treasury yield curve has continued to flatten and is close to inverting, meaning short-term yields would be higher than longer-term yields. We are closely monitoring the yield curve since we believe it is an important forecasting tool. The yield curve is a signaling mechanism for the Fed as it seeks to manage inflation expectations and keep the economy from overheating. Furthermore, we think long-term yields are a reasonable proxy for return on invested capital, and short-term yields are a good proxy for the cost of capital. Once the business cycle reaches the stage at which the cost of financing exceeds the return on capital, we think that is an important inflection point that could presage a recession.

Historically, an inverted yield curve has been an accurate forecaster of recession. This time, however, there may be different dynamics at work. The massive amount of longer-term Treasuries that the Fed purchased during the years that it was attempting to stimulate economic growth are still being held on the central bank's balance sheet. This has created a scarcity in the supply of longer-term Treasuries, which is being met by robust demand. As a result, we believe demand for long-term debt may be having a greater influence on the curve than the pace of Fed rate hikes. If we are correct in this assessment, then we think this presents a more benign backdrop that is less indicative of near-term recession.

On the trade front, at the end of May, the Trump administration announced tariffs on steel and aluminum imported from the European Union, Canada, and Mexico. It then applied tariffs to $50 billion in Chinese imports to the United States, a move that was designed to punish China for unfair trade practices. President Trump escalated the trade conflict with China in mid-June, asking his administration to identify a new list of $200 billion in Chinese goods that would be penalized with tariffs. The Chinese government immediately threatened to retaliate with its own equivalent tariffs on U.S. goods. The president has also threatened to impose tariffs on global automobile imports. As of quarter-end, investors remained on edge as to the full scope of President Trump's global trade offensive.

Before we discuss performance, would you summarize the fund's overall investment objective and strategy?

Putnam Multi-Asset Absolute Return Fund seeks a positive return exceeding the return of Treasury bills over a reasonable period of time, regardless of market conditions. The fund seeks to achieve risk-and-return characteristics by dynamically allocating assets using a combination of directional [or market sensitive] and non-directional [or market neutral] strategies. In addition, both the composition and total level of risk can be dynamically managed depending on market conditions and the prevailing opportunity set. The fund also employs strategies that may produce lower volatility over time.

How did the fund perform, and what factors had the biggest influence on performance?

It was an eventful second quarter for the fund. We started the quarter strong, gaining 1.35% in April, and the fund also generated positive performance in May. But these gains were mostly erased by negative results from our non-directional strategies in June. For the quarter overall, the fund's class Y shares posted a modest 0.25% gain.

Our directional strategies added value for the quarter, led by exposure to U.S. stocks, as well as broad index exposure to commodities. U.S. equities, as measured by the Russell 3000 Index, returned 3.89% for the second quarter, with the information technology sector generating the best performance. The S&P GSCI Index — a broad measure of commodities — rose 8.00%, fueled by a 14.20% advance in U.S. oil prices.

Within non-directional strategies, broad-based underperformance across our equity-selection alpha strategies — which are market-neutral trades designed to perform independently of global equity markets — weighed on the fund's performance. Specifically, our forensic accounting strategy — which identifies companies that we believe use aggressive accounting practices that can cause their stocks to underperform — delivered disappointing results. Long/short strategies in the United States, as well as in foreign developed and emerging markets, also worked against performance this period. One bright spot within equity selection was our fundamentally driven, U.S.-focused long/short strategy, which rebounded nicely during the second quarter after a difficult start to 2018.

Outside of equity selection, the fund benefited from strong performance in fixed-income selection, as well as in various alternative beta strategies, including an equity mean-reversion strategy, which seeks to capitalize on short-term fluctuations in the S&P 500. Overall, however, these pockets of non-directional strength were not enough to meaningfully offset weakness elsewhere.

What is your outlook, and how have you positioned the fund in light of that outlook?

Entering 2018, we were aware that extremely bullish market sentiment and stretched valuations had the potential to reintroduce volatility. However, we believed that global economic growth, strong corporate earnings, and the possibility of accelerated share buybacks driven by repatriation of cash held overseas would more than offset short-term setbacks. While we believe that the fundamental backdrop remains supportive for stocks, we have reduced the fund's overweight allocation and moved closer to a neutral target weight in equities. Our quantitative model remains slightly bearish, due to elevated valuations. Also, the likelihood of increasing share buybacks — one of the reasons for our overweight this year — has temporarily diminished since most companies are now in blackout periods.

We expect bond yields in the United States and globally to continue rising. However, the June announcement by European Central Bank [ECB] President Mario Draghi that the ECB's bond-buying program would end this December is likely to keep a short-term lid on global yields, in our view.

In corporate credit, given the tight level of spreads relative to history, we think it is prudent to focus the fund's directional-risk strategies in other areas.

We reduced the fund's overweight allocation to commodities after our quantitative model became more bearish and several oil-producing countries began reducing production cuts. Overall, however, we continue to have a bullish outlook for commodities.

During the second quarter, we added several new non-directional strategies to the portfolio, including strategies in equity and fixed-income selection, regional fixed income, commodity alpha, and alternative beta. As of quarter-end, various equity-selection alpha strategies account for the largest portion of non-directional risk.

Putnam Multi-Asset Absolute Return Fund (PDMYX)

Annualized total return performance as of 6/30/18

Class Y shares *Inception 12/23/08*	**Net asset value**	**ICE BofAML U.S. Treasury Bill Index**
Last quarter	0.25%	0.45%
1 year	2.37	1.31
3 years	2.33	0.67
5 years	3.79	0.43
Life of fund	4.92	0.31

Total expense ratio: 0.83%

What you pay: 0.82%

Returns for periods of less than one year are not annualized.

"What you pay" reflects Putnam Management's decision to contractually limit expenses through 4/30/19.

Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or a loss when you sell your shares. Performance assumes reinvestment of distributions and does not account for taxes. For the most recent month-end performance, please visit putnam.com. For a portion of the periods, the fund may have had expense limitations, without which returns would have been lower. Class Y shares are generally only available for corporate and institutional clients and have no initial sales charge.

The ICE BofAML U.S. Treasury Bill Index is an unmanaged index that tracks the performance of U.S. dollar-denominated U.S. Treasury bills publicly issued in the U.S. domestic market. Qualifying securities must have a remaining term of at least one month to final maturity and a minimum amount outstanding of $1 billion. You cannot invest directly in an index.

ICE Data Indices, LLC (ICE BofAML), used with permission. ICE BofAML permits use of the ICE BofAML indices and related data on an "as is" basis; makes no warranties regarding same; does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the ICE BofAML indices or any data included in, related to, or derived therefrom; assumes no liability in connection with the use of the foregoing; and does not sponsor, endorse, or recommend Putnam Investments, or any of its products or services.

The Russell 3000 Index is an unmanaged index of the 3,000 largest U.S. companies.

Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company.

The S&P GSCI Index is a composite index of commodity sector returns that represents a broadly diversified, unleveraged, long-only position in commodity futures.

The views and opinions expressed are those of the portfolio managers as of June 30, 2018, are subject to change with market conditions, and are not meant as investment advice. All performance and economic information is historical and is not indicative of future results.

The fund is not intended to outperform stocks and bonds during strong market rallies.

Consider these risks before investing: Allocation of assets among asset classes may hurt performance. The value of stocks and bonds in the fund's portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general financial market conditions, changing market perceptions (including, in the case of bonds, perceptions about the risk of default and expectations about monetary policy or interest rates), changes in government intervention in the financial markets, and factors related to a specific issuer or industry. These and other factors may also lead to increased volatility and reduced liquidity in the fund's portfolio holdings. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. Bond investments are subject to interest-rate risk (the risk of bond prices falling if interest rates rise) and credit risk (the risk of an issuer defaulting on interest or principal payments). Interest-rate risk is greater for longer-term bonds, and credit risk is greater for below-investment-grade bonds. Unlike bonds, funds that invest in bonds have fees and expenses. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are subject to prepayment risk and the risk that they may increase in value less when interest rates decline and decline in value more when interest rates rise. International investing involves currency, economic, and political risks. Emerging-market securities have illiquidity and volatility risks. Our alpha strategy may lose money or not earn a return sufficient to cover associated trading and other costs. Our use of leverage obtained through derivatives increases these risks by increasing investment exposure. Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. The fund's efforts to produce lower-volatility returns may not be successful and may make it more difficult at times for the fund to achieve its targeted return. Under certain market conditions, the fund may accept greater-than-typical volatility to seek its targeted return. The fund may not achieve its goal, and it is not intended to be a complete investment program. You can lose money by investing in the fund. The fund's prospectus lists additional risks.

This material is for informational and educational purposes only. It is not a recommendation of any specific investment product, strategy, or decision, and is not intended to suggest taking or refraining from any course of action. It is not intended to address the needs, circumstances, and objectives of any specific investor. Putnam, which earns fees when clients select its products and services, is not offering impartial advice in a fiduciary capacity in providing this sales and marketing material. This information is not meant as tax or legal advice. Investors should consult a professional advisor before making investment and financial decisions and for more information on tax rules and other laws, which are complex and subject to change.

A world of investing.®

Putnam INVESTMENTS

Request a prospectus or summary prospectus from your financial representative or by calling 1-800-225-1581. The prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

Putnam Retail Management

Putnam Investments | One Post Office Square | Boston, MA 02109 | putnam.com

TL104 311576 7/18